The Federal Reserve: Central Bank of the United States

Federal Reserve System

The Federal Reserve System was created by the Federal Reserve Act, which was passed by Congress in 1913, to provide a safer and more flexible banking and monetary system. For approximately 100 years before the creation of the Federal Reserve, periodic financial panics had led to failures of a large number of banks, with associated business bankruptcies and general economic contractions. Following the studies of the National Monetary Commission, established by Congress a year after the particularly severe panic of 1907, several proposals were put forward for the creation of an institution designed to counter such financial disruptions. Following considerable debate, the Federal Reserve System was established. Its original purposes were to give the country an elastic currency, provide facilities for discounting commercial credits, and improve the supervision of the banking system.

Economic Stability and Growth

From the inception of the Federal Reserve System, it was clear that these original purposes were aspects of broader national economic and financial objectives. Over the years, stability and growth of the economy, a high level of employment, stability in the purchasing power of the dollar, and a reasonable balance in transactions with foreign countries have come to be recognized as primary objectives of governmental economic policy.

Currency Circulation

An important function of the Federal Reserve System is to ensure that the economy has enough currency and coin to meet the public's demand. Currency and coin are put into or retired from circulation by the Federal Reserve Banks, which use depository institutions as the channel of distribution. When banks and other depository institutions need to replenish their supply of currency and coin—for example, when the public's need for cash increases around holiday shopping periods—depository institutions order the cash from the Federal Reserve Bank or Branch in their area, and the face value of that cash is charged to their accounts at the Federal Reserve. When the public's need for currency and coin declines, depository institutions return excess cash to a Federal Reserve Bank, which in turn credits their accounts.

Unfit and Counterfeit Notes

The Federal Reserve Banks and the U.S. Department of the Treasury share responsibility for maintaining the physical quality of United States paper currency in circulation. Each day, millions of dollars of deposits to Reserve Banks by depository institutions are carefully scrutinized. The Reserve Banks are responsible for receiving, verifying, authenticating, and storing currency and shipping it as needed. Currency in good condition is stored for later distribution. Worn or mutilated notes are removed from circulation and destroyed. Counterfeit notes are forwarded to the U.S. Secret Service, an agency of the Treasury Department.

Federal Reserve Notes

Virtually all currency in circulation is in the form of Federal Reserve Notes, which are printed by the Bureau of Engraving and Printing of the U.S. Treasury. The Reserve Banks are currently authorized to issue notes in denominations of $1, $2, $5, $10, $20, $50, and $100. Coins are produced by the Treasury's United States Mint.

Cash Transfers

Currency and coin are used primarily for small transactions. In the aggregate, such transactions probably account for only a small proportion of the value of all transfers of funds.